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524310—43

In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 916

EDISON BROTHERS STORES, INC., PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 26–33) is reported in 45 B. T. A. 472. The opinion of the United States Circuit Court of Appeals (R. 56–68) is reported in 133 F. 2d 575.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on February 3, 1943 (R. 69–70). The petition for rehearing was denied on March 3, 1943 (R. 83). The petition for a writ of certiorari was filed on April 12, 1943. The jurisdiction of this

Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Where a corporation, in 1935 and 1937, sells its own stock, previously acquired for the purpose, to its employes at a profit, whether the profit constitutes income within the meaning of Section 22 (a) of the Revenue Acts of 1934 and 1936 and the applicable Treasury Regulations.

2. Whether Article 22 (a)–16 of Treasury Regulations 86 and 94, promulgated under the Revenue Acts of 1934 and 1936, respectively, is valid.

3. Where the taxpayer satisfied a debt owing to its general counsel for services rendered by the transfer to counsel of shares of its capital stock which it had acquired at a cost less than the fair market value at the time of transfer, whether the taxpayer realized taxable income under Section 22 (a) of the Revenue Acts of 1934 and 1936 and the applicable Treasury Regulations. This depends upon the answers to the first and second questions.

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions,

> vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

The corresponding provision of the Revenue Act of 1936, c. 690, 49 Stat. 1648, is the same.

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

> ART. 22 (a)–16. *Acquisition or disposition by a corporation of its own capital stock.*— Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.
>
> But if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the cor-

> poration receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of the Act.

Article 22 (a)–16 of Treasury Regulations 94, promulgated under the Revenue Act of 1936, is the same.

STATEMENT

The facts, as stipulated (R. 18–26), and as found by the Board of Tax Appeals (R. 27–31), may be summarized as follows:

The taxpayer was incorporated in 1925, under the laws of Delaware, by the five Edison brothers who subscribed for and acquired the entire issue of 100,000 shares of its no par value common stock. Its principal office is located in St. Louis, Missouri. (R. 27.)

In 1929 the taxpayer reacquired from the five Edison brothers 5,000 shares of its stock at $15 per share for the purpose of sale and distribution to its employees; and the 5,000 shares which were held by the taxpayer in its treasury were designated in its annual statement as "Capital stock purchased for resale to employees" (R. 27).

During 1935, the first of the taxable years, the

taxpayer sold 980 shares of its common stock to certain of its key employees at a price of $25 per share. The Commissioner determined that in 1935 the taxpayer realized a gain in the amount of $10 per share or an aggregate amount of $9,800, representing the difference between the price which the taxpayer paid for the stock and the price which it received for the stock from its employees. (R. 29.)

In 1935 the taxpayer transferred 100 shares of its stock, previously purchased from its stockholders, to an attorney in payment of his bill of $3,000 for legal services rendered. At the time of this transfer the stock had a fair market value of $3,000. The taxpayer claimed a deduction of $3,000 in its tax return for 1935, but the Commissioner allowed a deduction of only $1,500, the cost to the taxpayer of the 100 shares in question. (R. 28.)

In 1937, the second of the taxable years, the taxpayer allotted and sold to certain of its employees 3,660 shares of its common stock at a price of $15 per share; taxpayer's cost basis for that stock was $5 per share (R. 30). The Commissioner determined that in 1937 the taxpayer realized a gain of $10 per share or an aggregate amount of $36,600, representing the difference between the price which the taxpayer paid for the stock and the price at which it was sold to its employees (R. 31).

The Board of Tax Appeals decided that the taxpayer realized no taxable gain from the sale of its stock to its employees in 1935, but that it did realize gains on such transactions in 1937. It also decided that the taxpayer realized no taxable gain when it paid its counsel with 100 shares of its stock with a fair market value of $3,000, but which cost the taxpayer only $1,500. (R. 31–32.) Both sides appealed to the Circuit Court of Appeals for the Eighth Circuit; the taxpayer appealed as to the year 1937 and the Commissioner as to the year 1935. The Circuit Court of Appeals decided that, with respect to both the year 1935 and the year 1937, all of the gains realized from the sale of taxpayer's own stock, previously acquired for the purpose, represented taxable income.

ARGUMENT

1. One of the reasons relied on by the petitioner for granting the writ in this case is that the decision of the Court below conflicts directly with the decisions of this Court in *Helvering* v. *Reynolds Co.*, 306 U. S. 110, and in *First Chrold Corp.* v. *Commissioner,* 306 U. S. 117.

In the *Reynolds Co.* case the corporation, in 1929, sold some of its stock, previously purchased from its stockholders, at a profit. During the year 1929 the Treasury Regulations provided in part that a corporation realizes no gain or loss from the purchase or sale of its own stock. That regulation had been in effect for a number of

years, but was amended by T. D. 4430, XIII–1 Cum. Bull. 36, approved May 2, 1934, so that it provided in part that whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all the facts and circumstances. It also provided that if a corporation deals in its own shares as it might in the shares of another corporation the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. The *First Chrold* case did not differ in any material respect and involved the tax year 1933.

This Court held that the amended regulation promulgated in 1934 could not properly be applied to transactions that took place in the year 1929 (*Reynolds Co.* case) or in 1933 (*First Chrold* case). In this case the transactions took place in 1935 and 1937, after the promulgation of T. D. 4430, so that here the Commissioner is applying the amended regulation prospectively and not retroactively. Consequently, this case differs materially from the *Reynolds Co.* and *First Chrold* cases. This Court has decided that regulations may be changed and applied prospectively. *Helvering* v. *Wilshire Oil Co.*, 308 U. S. 90, 100–101; *Helvering* v. *Reynolds*, 313 U. S. 428, 432.

After this Court decided the *Reynolds Co.* case a number of courts upheld the validity of the regu-

lations in question as applied prospectively and this Court has within the past year denied petitions for writs of certiorari in three of the cases. *Allen* v. *National Manufacture & Stores Corp.*, 125 F. 2d 239 (C. C. A. 5th), certiorari denied, 316 U. S. 679; *Trinity Corp.* v. *Commissioner*, 127 F. 2d 604 (C. C. A. 5th), certiorari denied, October 12, 1942, No. 220, this Term; *Commissioner* v. *Air Reduction Co.*, 130 F. 2d 145 (C. C. A. 2d), certiorari denied, November 16, 1942, No. 456, this Term; see also *Investment Corp.* v. *United States*, 43 F. Supp. 64 (E. D. Pa.).

The only decision to the contrary is *Stern Bros. & Co.* v. *United States*, 45 F. Supp. 583 (W. D. Mo.), in which a corporation in 1936 sold treasury stock to its employees at a profit. That case is now pending on appeal to the court below so that the decision in the instant case would probably control the *Stern Bros.* case and require a reversal of the judgment of the District Court.

2. The decision of the court below in upholding the Treasury Regulations would seem to be correct. If a corporation deals in its own stock as though it were property, that is, if it buys its stock for the purpose of selling it and not for the purpose of retiring it, the transaction may result in gain or loss. If it results in gain, it would appear to be income under the Sixteenth Amendment and under Section 22 (a) of the Revenue Act. The broad language of Section 22 (a) has repeatedly

been noted by this Court. *Irwin* v. *Gavit,* 268 U. S. 161, 166; *Douglas* v. *Willcuts,* 296 U. S. 1, 9; *United States* v. *Safety Car Heating Co.,* 297 U. S. 88, 93; *Helvering* v. *Stockholms &s. Bank,* 293 U. S. 84, 89.

The definition of income in the statute is intended to embrace whatever is commonly understood as income, and it is essentially coextensive with the scope of Congressional power under the Constitution. See *Merchants' L. & T. Co.* v. *Smietanka,* 255 U. S. 509, 519. In this case the taxpayer-corporation realized a gain in cash upon the sale of treasury stock to its employees in the amount of the excess of receipts from the sale of its stock over their cost to the taxpayer-corporation without any attendant change in the number or nature of its shareholding accounts. This is a typical case of realized corporate gain as commonly understood.

3. The petitioner argues that the treasury stock which was sold to its employees was the same as authorized but unissued stock and, therefore, the issuance of its stock to its employees was a purely capital transaction (Br. 28–31). But the difference between what was done in this case and what would have been done in the case of retirement is more than a difference in form. Important legal and practical distinctions are involved. The purchase by a corporation of its shares without retirement enables it to sell them without observing the preemptive right of shareholders; to sell

them without conformity to statutory or charter requirements that a reduction in capital stock be effected by a vote of the board of directors and of stockholders, and the filing of public notice. A corporation which is enabled to secure these advantages by refraining from retiring the stock cannot properly urge that what it did was tantamount to retirement and reduction of capital.

The Second Circuit, in the *Air Reduction Co.* case, held that under circumstances similar to those in this case the corporation was dealing in its own stock as though it were the stock of another corporation. See also, G. C. M. 16651, XV–2 Cum. Bull. 130 (1936).

CONCLUSION

The decision of the court below is correct and there is no conflict of decisions. It is, therefore, respectfully submitted the petition for writ of certiorari should be denied.

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